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In Search of explanations for risk management failures

Margaret Woods

Aston Business School, Aston University

m.woods@aston.ac.uk

Christopher Humphrey

Manchester Business School, The University of Manchester

Chu Yeong Lim

Singapore Management University

ABSTRACT

The global financial crisis has generated calls for better risk management to prevent the risk exposures and strategic management failings in recent years. Criticisms of risk management and measurement have been made. This conceptual paper seeks to add to this existing literature by arguing that risk management is not just a matter of models or methodologies but also their application in practice. We build on the work of Power by questioning whether the problem with Enterprise Risk Management (ERM) is one of implementation rather than design. Using examples from the financial services sector we demonstrate how the operation of risk management and control systems is fundamentally dependent upon the effective co-ordination of interlinked layers of risk defences. Poor co-ordination can lead to risk imbalances and control problems and when multiple imbalances interact and occur simultaneously, there is risk of a fundamental failure of the risk management system.

Analysing the dynamics of the internal and external relationships between risk managers, operational managers, the Board of Directors, regulators, rating agencies and stakeholders we identify three areas – risk architecture, information flows and ‘culture’ which together serve to create misunderstandings and alternative perspectives about risk management that is not consistent with the ERM model, creating imbalances that undermine the stability of the control system. We conclude that ERM implementation is hampered by the cumulative effect of failures to collaborate both within and outside the organization.

Keywords: